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FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of the Federal-State Joint Board on Universal Service	)))	CC Docket No. 96-45
	)	
Public Notice DA 96 1891	)	

Comments of the Competition Policy Institute on the Recommended Decision

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The Competition Policy Institute (CPI) is an independent non-profit organization which advocates state and federal regulatory policies to bring competition to telecommunications and energy markets in ways that benefit consumers. CPI appreciates the opportunity to respond to the Common Carrier Bureau's Public Notice seeking comment on the Recommended Decision of the Federal-State Joint Board on Universal Service. We offer responses to some of the questions posed by the Bureau in its Public Notice. For convenience, the Bureau's questions have been restated in the comments that follow.

Question #2. Low-Income.

What baseline amount of support should be provided to low-income consumers? Is the $5.25 baseline amount suggested in the Recommended Decision likely to be adequate?

In its *ex parte* filing with the Joint Board[1], CPI suggested that the federal Lifeline support be sufficient to result in a rate for the services within the definition of universal service which was half the national average rate, or half the prevailing rate, whichever was lower. We reiterate that recommendation here.

Using a national average rate of approximately $18.00 ($14.50 plus the SLC), the resulting maximum rate would be $9.00 for Lifeline recipients at the present time. In areas where the

[1] *Ex parte* submission of CPI, dated October 4, 1996.

prevailing rate is lower than the national average, the discount would be correspondingly smaller. The following table of hypothetical rates illustrates this proposal:

Jurisdiction	Prevailing Rate (including SLC)	Federal Lifeline Support	Resulting Lifeline Rate (before state support)
State 1 (or LEC 1)	$18.00	$9.00	$9.00
State 2 (or LEC 2)	$12.00	$6.00	$6.00
State 3 (or LEC 3)	$20.00	$11.00	$9.00

This proposal raises the total federal contribution for low-income assistance above the level contemplated in the Recommended Decision, a level which CPI is concerned may not be adequate. The proposed federal Lifeline component, acting alone, will reduce the bills for low-income consumers from an average of $18.00 to an average of $12.75, a rate which we believe is not affordable for many low-income consumers. Moreover, since this is an average, the resulting rate will be higher than $12.75 in many cases. Some states will act to provide additional state assistance. But CPI prefers for the federal program to provide a larger baseline support level to make it more likely that rates for low-income consumers remain affordable.

To the extent that the Commission determines that the baseline level of $5.25 is not sufficient, CPI recommends that the Commission adopt a method based on the principle illustrated in the table above.[2] This method has the merit of directing relatively more of the Lifeline support

[2]There are obvious variations on the method suggested by CPI. For example, the federal Lifeline support could be sized to result in a rate equal to 70 percent (instead of half) of the prevailing rate or the national average rate, whichever is lower.

toward the low-income customers in areas with the highest rates. In areas where rates are lower, the level of support is lower. This would appear to be an advantage over a system that provides a flat discount, independent of the actual rate.

How can the FCC avoid the unintended consequence that the increased federal support amount has no direct effect on Lifeline subscribers' rates in many populous states with Lifeline programs, and instead results only in a larger percentage of the total support being generated from federal sources?

Although CPI supports a different structure (described above) than the one contained in the Recommended Decision, we respond to this question assuming the structure recommended by the Joint Board, i.e., increasing the federal Lifeline support by $1.75 per month, from the current level of $3.50 to a new level of $5.25.

In New York, with Lifeline rates currently at $1.00, federal Lifeline support could not be increased by $1.75 without achieving this "unintended consequence." CPI believes that the Commission should not view this outcome as a defect of the Joint Board's recommendation, but merely an exceptional case that results from a state having been much more aggressive than average in setting the Lifeline discount within the state. Since neither the FCC nor the State of New York expects Lifeline phone rates to be priced at *negative* seventy-five cents per month, either the federal contribution or the state contribution will be reduced. In this case, the FCC could reasonably limit the federal contribution to $4.50 so that the price of phone service is not less than zero. Alternatively, it is also reasonable in this case to expect the State of New York to reduce its contribution, especially if the state contribution remains at least as large as the federal contribution.[3]

But the New York example is a special case of a broader issue. The Commission may want to consider this larger question: how can the FCC act to ensure that an increase in the federal support for low-income assistance is not offset by reductions in state contributions generally? Although we would not expect states to react this way in wholesale fashion, this is a possible outcome in at least some states where Lifeline assistance never enjoyed broad political support. This is potentially a more difficult problem.

Clearly, national universal service policy would prefer that a state's contribution to universal service not be reduced from its current level in response to a $1.75 increase in federal Lifeline support. Otherwise, increased federal Lifeline support merely results in a shift of responsibility from states to the federal program. On the other hand, CPI does not think that the FCC should attempt to dictate to states exactly how their Lifeline determinations are made. The federal contribution is subject to this risk as long as it "goes first."

The FCC could induce states to maintain their share of the load by declining to increase support beyond the current level of $3.50 to the extent a state reduces its contribution below the existing

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[3]Another way of ensuring that Lifeline assistance is increased in such "populous states" would be to for the FCC to act to increase penetration of Lifeline assistance in those states; one approach is to require that enrollment in Lifeline be made relatively automatic (e.g., matching telephone bills to welfare recipient lists). In this way, the state contributions would be increased, along with a corresponding increase in federal support.

level. Under this approach, the Joint Board's Recommended Decision could be characterized as providing a "bonus" of $1.75, available for a state to use for Lifeline as long as the state maintains its level of support.

This approach would help avoid the "unintended consequence" of shifting responsibility without actually helping the consumer. A state's decision to reduce benefits would be met with a response from the FCC to scale back the federal contribution. Presumably this would reduce the state's incentive to cut benefits. However, it could also place the low-income consumer in the midst of a game of "chicken" between the FCC and state commissions or legislatures.[4]

To illustrate these concepts: suppose the prevailing telephone rate in a state is $16.00, ($12.50 plus $3.50 SLC). Suppose the state is matching today's federal contribution of $3.50, so that the recipient pays a Lifeline rate of $9.00 ($16.00-3.50-3.50). Under the Joint Board's Recommended Decision, the new federal support would be $5.25, lowering the Lifeline rate to $7.25 (16.00-5.25-3.50) if nothing else changes.

Now suppose the state reduces its support to $2.00 from $3.50. The low-income consumer would experience a price of $8.75 ($16.00-5.25-2.00). Thus, while the federal support increased by $1.75, the consumer's rate dropped by only $0.25. The FCC could try to dissuade the state

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[4]In view of the earlier discussion about New York, there should be an exception for states whose existing contributions were larger than the federal contribution. I.e., New York should be permitted to reduce its contribution to avoid negative Lifeline rates as long as its contribution was at least as large as the federal contribution.

from taking such action by making the increased federal support available only if the state maintained its existing level of funding. Such a policy would provide this inducement; on the other hand, it would tend to magnify the negative effects if a state acts to reduce Lifeline support.

Finally, the FCC could combine the CPI proposal of proportionate targeting of assistance with an inducement to states: I) set the baseline Lifeline support (as above) to achieve a rate that is a percentage of the lower of prevailing rates or the national average rate; ii) provide a additional support beyond that level only if a state maintains the contribution in effect previously.

Question #5. Administration.

Should contributions for high cost and low-income support mechanisms be based on the intrastate and interstate revenues of carriers that provide interstate telecommunications services, based on the factors enumerated in the Recommended Decision?

CPI supports the use of combined interstate and intrastate revenues as the basis for allocating the costs of all components of the federal Universal Service Fund. The Joint Board correctly recommended this approach for support for schools and libraries; we think the logic of this method is at least as compelling for high cost and low-income support.

Using combined revenues offers several advantages compared to the proposal to use only interstate revenues for the federal program and only intrastate revenues for possible state programs. We refer to these two options as "combined revenues" and "separated revenues". Here are the advantages of the combined revenues approach.

The use of combined revenues --

- Provides an equitable allocation among telecommunications providers;
- Is independent of assumptions about whether a state enacts a universal service fund;
- Is adaptable to changing traffic patterns;
- Is consistent with the Joint Board's overall structural approach to Universal Service;
- Provides correct incentives for carriers on classification of traffic and revenues.

We discuss each of these characteristics.

Equity. The essential challenge to the FCC and the states is to construct a bi-jurisdictional system of support that provides sufficient funding for universal service and fairly apportions the responsibility among telecommunications providers. There are two dimensions to a fair apportionment: I) the measurement of a provider's size; and ii) coordination between jurisdictions to ensure a fair result regardless of how a provider's revenues divide between state and federal regulatory jurisdictions.

As to the first component, we support the Joint Board's conclusion that net revenues[5] provides the correct measure for assessment. The net revenues basis approximates the "value-added" contribution that a provider makes to the telecommunications marketplace, thereby measuring

[5]Here "net revenues" means revenues minus payments to other telecommunications providers.

the "stake" a provider has in a ubiquitous telecommunications network. This is a fair basis on which to apportion responsibility.

We now turn to the jurisdictional issue. If there were just one jurisdiction (only state or only federal), there would be agreement that a provider's combined interstate and intrastate revenues should be used to apportion responsibility for universal service. For example, if universal service were left only to the states, we doubt anyone could credibly argue that universal service support was the responsibility of carriers only to the extent they had intrastate revenues, ignoring interstate revenues. Similarly, if there were only a federal USF, few would argue that the intrastate operations of carriers should be ignored. Combined revenues would be used.

The challenge facing the Commission is to achieve this same non-controversial result when two jurisdictions are introduced. CPI asserts that, as long as states are able to use a combined revenue basis to fund state USF programs, the combined revenue approach at the federal level achieves both of these non-controversial results simultaneously. At each jurisdictional stage of universal service responsibility, each carrier will be assessed on a consistent basis. In this way, the state and federal USFs can operate in a separate and complementary fashion, yet produce a joint result which is equitable to all carriers simultaneously.[6]

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[6]The Commission should not be swayed by arguments that the combined revenues approach constitutes a "double" assessment on intrastate revenues. If we admit its vocabulary, this argument concludes that interstate revenues would also be assessed "twice." The key fact is, of course, that the assessment rates using combined revenues are lower than they would otherwise be at each jurisdiction, compared to separated revenues and assuming a fixed size of all USF funds, state and federal.

Independence. The fairness of the separated revenues approach depends on assumptions that are nearly impossible to meet. To be fair across telecommunications providers, the separated revenues approach assumes that each state adopts a universal service mechanism and that the ratio of the aggregate state plans to the federal USF is the same as the ratio of aggregate intrastate revenues to interstate revenues. If the federal USF is apportioned on the basis of separated revenues and a particular state declines to adopt a state universal program (something many states may elect) a carrier with intrastate revenues will support neither the federal USF nor a state universal service effort. This conflicts with the requirement of the Telecommunications Act of 1996 requiring support to be equitable and non-discriminatory.

On the other hand, the fairness of the combined revenues approach does not rely on the assumption that any particular state adopts a state universal service plan. Using combined revenues, carriers are assessed in proportion to their share of the total national market or the total state market consistently at each point. This independence is a considerable advantage for the combined revenues approach.

Adaptability. The Commission should consider that the underlying bases for apportionment will change over time as carriers enter new markets. Today's interexchange carriers, for example, will be new entrants in the local telecommunications markets. It is important, for competitive neutrality, that the allocation of the universal service support evolve with this changing revenue basis. Clearly, using the combined revenues method for both federal and state USFs will track those changes since all revenues are used at each stage.

On the other hand, a system based on separated revenues is far less able to recognize and accommodate such changes. If separated revenues are used, growth in local revenues will not change a provider's share of the federal USF, even though it is exactly these competitive inroads which are driving the need for an explicit support mechanism.

Consistency. CPI submits that the combined revenues approach is most consistent with the Joint Board's own characterization of the challenge. In its Recommended Decision, the Joint Board speaks frequently about the need for the state and federal efforts to be complementary. The combined revenues approach allows the efforts to complement each other by ensuring that both jurisdictions supply universal service support on the same basis, using the same measures. "Separating" revenues and costs is an artificial exercise when the object is to support the same set of services, from assessments on "all" telecommunications providers. Instead of producing "complementary" efforts, the separated revenues method produces "disjoint" efforts. Further, using combined revenues is consistent with the Joint Board's recommended funding approach for support for schools and libraries.

Correct Incentives. Using separated revenues creates incentives for providers to mis-classify revenues from interstate to intrastate or vice versa. The exact incentive will be determined by the relative size of a given state's USF compared to the federal USF. Together with the practical difficulties of classification, this presents a substantial disadvantage for the separated revenues approach. The combined revenues approach eliminates this incentive since, for a given state USF assessment, the allocation factor will be unaffected by the balance of interstate and intrastate revenues. There remains an incentive is to mis-classify interstate revenues between states, a practice that will be more difficult to achieve.[7] These issues are discussed in greater detail below.

Should the intrastate nature of the services supported by the high cost and low-income programs have a bearing on the revenue base for assessing funds?

All telecommunications carriers benefit from a network subscribed to by the maximum number of telephone users. This "network externality" comprises the economic justification for a policy of universal service. There is no necessary connection between the intrastate nature of the services supported and the revenue basis for assessing funds except this: no carriers should be exempted, either in whole or in part (i.e., in proportion to their intrastate revenues). After all, the services contained in the definition of universal service, while local, are necessary to obtain any other telecommunications, either interstate or intrastate. It is this connection that links all carriers (in proportion to combined net revenues) to the task of universal service support.

We also note that future additions to the definition of universal service may include services that

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[7]As we advocated in earlier comments, the FCC should require each interstate carrier to report its interstate revenues attributable to each state. Clear rules and reporting requirements here will defeat incentives to mis-classify revenues between states and will provide states with the information needed to derive the state-specific combined revenues factors. (See CPI *ex parte* submission, dated October 4, 1996).

are today considered "interstate" in nature. The Commission should strive to make its decision durable and independent of changes in list of supported services.

Should contributing carriers' abilities to identify separately intrastate and interstate revenues in a evolving telecommunications market and carriers' incentives to shift revenues between jurisdictions to avoid contributions have a bearing on this question?

Yes, there are three ways in which carriers' ability to distinguish interstate and intrastate revenues should bear on whether the FCC uses combined revenues or separated revenues to apportion USF responsibility. Each of these considerations supports the use of combined revenues.

First, the existence of bundled "intrastate" and "interstate"services creates both a theoretic and practical problem for reporting . Most analysts expect competition to drive carriers to provide customers with one-stop shopping, probably with a single price for a bundle of services. While it will be possible for a carrier to say in which state the transaction occurred (where the customer purchased the bundled service) the allocation of revenues between interstate and intrastate services will be arbitrary and subject to dispute. It is likely that some carriers would have no use for such information, even if they are able to provide arbitrary estimates.

Second, it may be an unnecessary burden for some carriers to classify traffic as interstate or intrastate. Carriers' networks could be constructed in such a manner that such information is not readily available or not particularly meaningful. Since most new carriers will not be subject to separations requirements, it could be costly, and not otherwise productive, for them to mimic separations formulae. Given that new networks are diverging in design from traditional networks, even the meaningfulness of these distinctions will become suspect.

Third, the use of separate interstate and intrastate allocation factors could induce some carriers to "mis-classify" traffic as either interstate or intrastate, depending on whether a particular state adopts a universal service fund and the level of assessment the state makes. States and the FCC could find themselves in the grips of "adverse selection" wherein the revenue base will shift away from the jurisdiction with the greatest need for high-cost or low-income support. One need not ascribe dishonest motives for this practice, merely business judgment. As a practical matter, many judgments about how traffic is classified will be within the legitimate discretion of the reporting provider to determine.

In conclusion, CPI believes that there is a very compelling case for the Commission to use "combined revenues" as the basis for apportioning responsibility for support for universal service. Our support for this method, however, is premised on the ability of states to use the corresponding factor (intrastate revenues plus interstate revenues attributed to the state) to apportion responsibility for state universal service funds.

Respectfully submitted,

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I, Heather Bloxham, do hereby certify that copies of the foregoing Comments were served, by first class mail, postage prepaid on this 19th day of December 1996 to the following parties.

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